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How will Inflation and Rising Interest Rates Change Japan's Fiscal Situation?

While the ratio of government debt to nominal GDP will decline in the short term, interest payments will surge in the future

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Summary

- Japan has a large amount of government debt and is easily influenced by interest rates. Using the case in which long-term interest rates rise to slightly less than 3% as projected by the Cabinet Office, interest payments on JGBs in fiscal 2031 will increase by more than 5 tril. yen from FY2022. Furthermore, the refinancing of JGBs following the rise in interest rates is expected to increase interest payments by more than 20 tril. yen.

- On the other hand, annual inflation of around 2%, which is compatible with economic growth, is expected to reduce the nominal GDP ratio of government debt in the short term and increase fiscal sustainability. For fiscal consolidation, efforts to achieve primary balance surplus and strengthen economic growth remain important, but inflation may also become an important factor.

- Under the second supplementary budget, the issuance of new JGBs in the amount of 22.9 tril. yen is planned as a financial resource. Depending on interest rate trends, this could increase interest expenses by around 1.2 tril. yen in cumulative total through fiscal 2031. While the second supplementary budget is expected to have the effect of protecting the people's livelihood and promoting economic growth, it is important to give due consideration to the future fiscal impact when formulating economic measures.

Attention
This report is a summary translation. The official document is only in Japanese.